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FILED
APR 29 2013
SUPERIOR COURT
BETTY J. GOULD
THURSTON COUNTY CLERK

SUPERIOR COURT OF WASHINGTON
IN AND FOR THURSTON COUNTY

COSTCO WHOLESALE CORPORATION *et al*, Plaintiff(s), v. STATE LIQUOR CONTROL BOARD, Defendant(s).	NO. 12-2-01312-5 COURT'S OPINION **(CLERK'S ACTION REQUIRED)**

This matter comes before the Court on Petitioners Washington Restaurant Association, Northwest Grocery Association, and Costco Wholesale Corporation's ("Petitioners") Petition for Review challenging a variety of rules promulgated by Respondent Washington State Liquor Control Board ("Board") as a result of the passage of Initiative 1183 ("I-1183"). I-1183 was passed by a vote of the people in November 2011. The parties summarize the Initiative as follows:

> The Initiative changed the State's approach to regulating the distribution and sale of liquor in Washington, as acknowledged in the first section of I-1183, the recitation of purpose: "The people … find that the state government monopoly on liquor distribution and liquor stores in Washington and the state government regulations that arbitrarily restrict the wholesale distribution and pricing of wine are outdated, inefficient, and costly to local taxpayers, consumers, distributors, and retailers." Laws of 2012, ch. 2, §101(1). The Initiative removed the State government from the commercial business of distributing, selling, and promoting the sale of liquor. *Id.* The recitation of purpose further stated that privatization would "allow[] the state to focus on the more appropriate

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> government role of enforcing liquor laws and protecting public health and safety concerning all alcoholic beverages." Laws of 2012, §101(2)(b).

Joint Statement of Facts, ¶ 7. In short, the Initiative was an ambitious modification of the long-standing three-tier structure in this state that, among other features, ended state-owned liquor stores.

On March 14, 2012, the Board filed the first set of proposed permanent rules implementing I-1183. This first set contained 16 new rules to implement the Initiative and amended six existing regulations. Joint Statement of Facts, ¶ 17. On April 18, 2012, the Board filed a second set of proposed permanent rules. Joint Statement of Facts, ¶ 19.

The Notice of Rulemaking for both sets of rules stated that the Board decided not to conduct a Small Business Economic Impact Statement ("SBEIS") pursuant to RCW 19.85.030(1) because the proposals had "a positive impact on businesses or individuals who wish to sell spirits in the state of Washington." Joint Statement of Facts, ¶¶ 18-19.

Following a series of public hearings and receipt of other industry comment, the Board's Rules Coordinator filed the first set of rules on June 5, 2012, along with the required Concise Explanatory Statement ("CES"). On August 1, 2012, the Rules Coordinator filed the second set of rules and the required CES. Joint Statement of Facts, ¶¶ 22, 24.

On June 21, 2012, Petitioners filed an action in Thurston County Superior Court challenging the substance of six rules and the process by which the Board adopted the first set of rules. Joint Statement of Facts, ¶ 27. Petitioners filed a second petition for review to challenge the second set of rules on August 17, 2012.

Broadly speaking, Petitioners make two types of challenges. First, they challenge the procedural adequacy of the rulemaking process through the sufficiency of the CESs and the failure to prepare a SBEIS. Second, Petitioners substantively challenge several specific rules, labeled by the Court as follows:

a. "24 Liter" Rules (WAC 314-02-103; WAC 314-02-106).
b. COA Ten Percent Fee Rule (WAC 314-23-030).
c. Delivery Location Rule (WAC 314-23-020; WAC 314-24-180).

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d. Rules that Fail to Mirror Statute (WAC 314-23-001; WAC 314-02-103).

The Court reviewed the voluminous pleadings and attachments submitted by the parties and heard oral argument on April 4, 2013. Having considered these materials and arguments, the Court addresses Petitioners' procedural complaints first, followed by the substantive challenges to the specific rules.

Standard of Review.

Agency rules are presumed valid. *Anderson, Leech and Morse, Inc. v. WSLCB*, 89 Wn.2d 688, 695, 575 P.2d 221 (1978). The party claiming a rule is invalid has the burden of proof, and the rules only need to be reasonably consistent with the statutes they implement. *Id.* In addition, because this case is reviewed under the provisions of the Administrative Procedures Act, chapter 34.05 RCW, a rule is invalid only if it (1) "exceeds the statutory authority of the agency," (2) "violates constitutional provisions," (3) "was adopted without compliance with statutory rulemaking procedures," or (4) "is arbitrary and capricious." RCW 34.05.570(2)(c).

Allegations of Procedural Defects.

Petitioners make two general procedural arguments that, if accepted, could invalidate all of the rules. First, Petitioners argue that the Board failed to have sufficient "Concise Explanatory Statements" for each set of rules as required by RCW 34.05.325(6). Second, Petitioners argue that the Board failed to undertake a Small Business Economic Impact Study as required by chapter 19.85 RCW.

1. Concise Explanatory Statement ("CES") (RCW 34.05.325(6)).

Petitioners claim that the Board's CESs were insufficient because they failed to adequately explain the bases for the rules (citing *Anderson, Leech & Morse, Inc. v. Liquor Control Bd.*, 89 Wn.2d 688, 693, 575 P.2d 221 (1978)); *see also* RCW 34.05.325. The Board responds that CESs adequately described the Board's response to the comments it received and the reasons for rejecting certain stakeholder comments.

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The Court agrees with Petitioners that more complete statements directly addressing the concerns of the stakeholders who were unsuccessful in the rulemaking process would have been more complete. But strict compliance with the statute is not required; only *substantial* compliance is required. *See Anderson, Leech & Morse, Inc.*, 89 Wn.2d at 693. Here, these CESs do no more than the minimum, but the Court is persuaded that they are sufficient to meet the minimum requirements of the law.

2. "Small Business Economic Impact Statement" (Chapter 19.85 RCW).

It is undisputed that the Board did not conduct a Small Business Economic Impact Statement ("SBEIS") under chapter 19.85 RCW. Joint Facts ¶ 20 ("The agency record does not include, and the Board did not otherwise consider, any specific information regarding the anticipated regulatory impact of the proposed rules as contemplated by RCW 19.85.030."). SBEISs are addressed in RCW 19.85.030 that provides, in part, "[i]n the adoption of a rule under chapter 34.05 RCW, an agency shall prepare a small business economic impact statement ... [i]f the proposed rule will impose more than minor costs on businesses in an industry ... ."

In this case, the Board's stated reason for not preparing such a statement was because the proposals had "a positive impact on businesses or individuals who wish to sell spirits in the state of Washington." In briefing and at oral argument, the Board further supports its decision by stating that any imposition of costs on business is caused by the underlying statute (I-1183), not its rules.

Neither party has offered authority to the Court to assist the interpretation of chapter 19.85 RCW. No appellate authority has been cited that answers such questions as when an agency may avoid the obligation of preparing an impact statement, how the Court should evaluate an agency decision under RCW 19.85.030, or what happens if the failure to prepare such a statement is deemed a violation of the statute.

Notwithstanding the absence of guidance, the Court is not persuaded by the Board's argument that any imposition of costs on small business should be blamed on the underlying

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statute, not its rules. Since all rules must be reasonably consistent with their related statutes, *all* imposition of costs on business by any given rule could be blamed on its underlying statute. Further, even when the bulk of the impact on industry is arguably caused by an underlying statute, rule drafting still involves a series of judgments by the agency; certainly, industry participants can be affected differently depending on those rulemaking judgments.

In this case, the Board made an initial threshold decision that these rules did not negatively affect small business and, therefore, no further study was necessary. Restraint dictates that courts should be hesitant to second-guess this threshold decision that a given set of rules do, or do not, impose costs on business. However, at a minimum, some level of deliberation would appear to be necessary and required by chapter 19.85 RCW on this initial decision of whether to prepare an SBEIS in the first place. Here, notwithstanding the Board's optimistic statement about the "positive impact" on spirits sales, it is stipulated that the Board made no attempt to consider "the anticipated regulatory impact of the proposed rules." Joint Facts ¶ 20. Given that admission, there is nothing that the Court needs to "second-guess" – the record is devoid of *any* consideration by the Board of the imposition of costs of these rules on small business.

While the precise boundaries of what chapter 19.85 RCW requires may be unclear, more is necessary than what was done by the Board. Accordingly, the Court finds that the Board failed to substantially comply with chapter 19.85 RCW. However, subject to the validity of specific rules discussed below, the Court will permit all other rules to remain effective pending the Board compliance with this statutory requirement.

Challenges to Specific Rules.

1. "24 Liter Rules" (WAC 314-02-103; WAC 314-02-106).

Under the modified three-tier system created by I-1183, on-premises retailers of alcohol (such as restaurants) are not generally permitted to purchase spirits and wine from off-premises retailers (such as grocery stores). I-1183, however, included an exception – the

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ability of on-premises retailers to purchase spirits and wine from off-premises retailers of the limited quantity of 24 liters "per transaction."

The record shows much disagreement about how 24 liters "per transaction" should be interpreted. Ultimately, the Board determined that the statute would mean very little without a temporal restriction. As a result, a "per day" limitation was written into the rules.

> No single sale to an on-premises liquor licensee may exceed twenty-four liters. *Single sales to an on-premises licensee are limited to one per day.*

WAC 314-02-103(2) (ital. added); *see also* WAC 314-02-106(1)(c).

Petitioners challenge the second sentence of these rules claiming that the Board improperly added to the plain language of the statute. Since I-1183 did not include any "per day" limit, Petitioners argue that the rules are invalid. The Board counters that I-1183's language is subject to more than one interpretation, and that its chosen solution to add the "per day" restriction is a "legitimate clarification" that is consistent with legislative scheme, comments from stakeholders, and common sense. *See e.g.* Board's Brief at p. 16. Without the "per day" restriction, argues the Board, multiple "transactions" of 24 liters could take place at one time which would effectively gut the general prohibition against sales between these types of retailers.

The parties agree, however, that the rule without the "per day" restriction would not be meaningless – there would still be some measure of "friction" to the transactions between retailers (there is disagreement on how much friction would result). The Board concedes that even without the "per day" restriction, multiple transactions of 24 liters would still require multiple invoices and other record-keeping obligations.

The Board has argued persuasively that the 24 liter limitation makes much more sense with a "per day" limitation. The Court agrees that the 24 liter rules with a "per day" restriction may actually be more consistent with the overall statutory scheme than I-1183's original statutory language. Without question, the 24 liter rules would be more meaningful with the

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inclusion of "per day" restriction. But the question is not whether the rules are more meaningful with this added restriction, the question is the Board's authority to impose them.

Petitioners cite authority suggesting that agencies may not correct poorly considered laws through rulemaking. *Dot Foods, Inc. v. Department of Revenue,* 166 Wn.2d 912, 215 P.3d 185 (2009); *Edelman v. State ex rel. Pub. Disclosure Commission*, 152 Wn.2d 584, 99 P.3d 386 (2004). In *Dot Foods*, our Supreme Court observed that, even though the agency's interpretation resulted in the statute being clearer, affirming the agency's interpretation would require importing "additional language into the statute that the legislature did not use. [The court] cannot add words or clauses to a statute when the legislature has chosen not to include such language." *Id.* at 920 (citing *State v. J.P.*, 149 Wn.2d 444, 450, 69 P.3d 318 (2003)).

Consistent with these authorities, it is not the Board's place, nor this Court's, to infuse a policy into statutory language that is not there, even if that policy improves the statute. *State v. Wilson*, 117 Wn. App. 1, 14, 75 P.3d 573 (2003) (the Court must ascertain the legislative intent not from what should have been said, but from the language of the statute.). I-1183 included no temporal restriction on sales between retailers, merely a "per transaction" limitation. The Court is persuaded that this original language is not meaningless, and, further, that the additional "per day" restriction substantively changes this original language. Accordingly, the Board exceeded its authority in adding to these provisions in the statute; the 24 liter rules (WAC 314-02-103(2); WAC 314-02-106(1)(c)) are invalid.

2. Ten Percent (10%) Fee Rule (WAC 314-23-030).

Petitioners next challenge the rules that require Certificate of Authority (COA) holders to pay a 10% fee on all liquor sales. Under the new statutory scheme put in place by I-1183, distributor licensees must pay a 10% fee on sales. RCW 66.24.055. Meanwhile, certain non-distributors are entitled to sell limited quantities as if they were distributors under a "Certificate of Authority."

The challenged rule requires these COA holders to pay the 10% fee on all liquor sold when they act as a distributor. Petitioners argue that imposing these fees on these COA

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holders is directly contrary to I-1183 which was precise in its language -- the fee is assessed only on actual licensed distributors.

The Board, on the other hand, justifies imposing this fee by referencing its overall regulatory scheme. Before the passage of I-1183, the law required that an "industry member" operating "as a distributor" be subject to the laws and rules applicable to distributors. RCW 66.24.640.[1] Since this law, RCW 66.24.640, remains, the Board argues that harmonizing the assessment of fees required by I-1183 with RCW 66.24.640 requires that the 10% fee be assessed to COA holders when they "operate as distributors."

The Court agrees with the Board that imposing the 10% fee on COA holders for their sales as distributors is reasonably consistent with the statutory scheme read as a whole and does not directly conflict with provisions of I-1183. Accordingly, imposing this fee is within the Board's authority.

3. Delivery Location Rule – (WAC 314-23-020; WAC 314-24-180).

Petitioners next challenge WACs 314-23-020 and 314-24-180 which impose new delivery restrictions on wine and spirits purchases by requiring distributors to sell and deliver product only from their licensed premises. Petitioners base their challenge on the absence of explanation justifying these rules in the record, arguing that the record contains no comments, discussion, or other analysis of these new restrictions.

The Board claims that it has the authority to adopt these rules under its general authority provided by RCW 66.08.030, and, further, that the new delivery requirements are necessary to assure proper tracking of product. According to the Board, it has always had the authority as part of its public safety functions to regulate the tracking of the product that enters the state, where it goes, and who has possession of it.

[1] "'Industry member' means a licensed manufacturer, producer, supplier, importer, wholesaler, distributor, authorized representative, certificate of approval holder, warehouse, and any affiliates, subsidiaries, officers, directors, partners, agents, employees, and representatives of any industry member." RCW 66.28.285.

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The Court agrees with the Board. "The powers of the Board are very broad." *Anderson, Leech & Morse, Inc.*, 89 Wn.2d at 694. While the passage of I-1183 modified fundamental aspects of the three-tier system, the Board's underlying obligation to regulate the commercial flow of beverage alcohol remains unchanged. Viewed in this context, the delivery location rules were a valid exercise of the Board's rulemaking authority.

4. Rules that "Fail to Mirror" Underlying Statutes (WAC 314-23-001; WAC 314-02-103).

In this final category, Petitioners challenge several rules for failure to include all the statutory exceptions found in the associated statute. As an example, Petitioners explain:

> RCW 66.28.330 governs spirits pricing. One restriction prohibits a spirits distributor from selling below acquisition cost, but provides an exception if "the item sold below acquisition cost has been stocked" for at least six months. RCW 66.28.330(1). But WAC 314-23-001(2) omits this exception. Facts ¶ 27(e).

Petitioners' Opening Brief at 28 (*see also id.* re: WAC 314-02-103).

The Board agrees that these rules do not include all portions of their underlying statutes. However, the Board argues that nothing requires a rule to copy its underlying statute verbatim, and, in the end, the statutory provisions will still always govern.

At oral argument, the Board conceded that drafting rules that list some, but not all, of the parts of the underlying statute is not "the best way to do it." The Court agrees. Heavily regulated entities *should* understand that both statutes and administrative rules must be consulted prior to determining a course of action. However, it is, in the Court's view, poor agency practice to draft rules that, on their face, appear to cover all aspects of a regulatory issue, but in fact do not. Agencies should endeavor to clarify obligations for regulated entities through rulemaking. Far from providing clarification, these rules risk creating unnecessary confusion.

That being said, neither party cited to the Court authority that the failure of rules to be inclusive of all parts of the underlying statute is fatal. To be sure, if rules become too

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confusing, even if they are technically correct, the line of arbitrary and capricious is approached. These specific rules (WAC 314-23-001; WAC 314-02-103), however, even with their imperfections, fall short of being invalid.

CONCLUSION

Accordingly, the Petition for Review will be granted in part and denied in part. The Court will sign an order consistent with this ruling. The order should reflect that the Board failed to appropriately address its obligations under chapter 19.85 RCW regarding the preparation of a Small Business Economic Impact Statement, and the 24 liter rules (WAC 314-02-103; WAC 314-02-106) are invalid. The ruling should also reflect that while the Board is undertaking its obligations under chapter 19.85 RCW, the invalidity of the remaining rules is stayed.

Dated : April 29, 2013.

Erik D. Price, Judge

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